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C O N F I D E N T I A L SECTION 01 OF 02 RIGA 000249

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TAGS: PGOV KCOR LG

SUBJECT: DEVELOPMENTS IN ANTI-MONEY LAUNDERING EFFORT

REF: A. 05 RIGA 313 B. 08 RIGA 425 C. 08 RIGA 446 D.  
RIGA 690

Classified By: Charge d'Affaires a.i. Bruce Rogers for reason 1.4 (b)

¶1. (C) Summary: Since the 2005 U.S. Patriot Act actions against two Latvian banks the government and banking industry have worked hard to regain international trust in that sector. Although there is more work to do, new Anti-Money Laundering (AML) laws are in place, and the Financial Intelligence Unit (FIU) is receiving fewer, but more useful, suspicious transaction reports (STRs) from banks. Although the economic downturn has been devastating in Latvia, the Financial and Capital Market Commission (FCMC) and the Association of Latvian Commercial Banks (ALCB) agree that banks' AML systems have not been adversely affected. Parex Bank, always a cause for concern, is under tight government control and is in less of a position now to be a money laundering concern with the help of regulatory scrutiny and new investment partners. It is important to maintain vigilance in dealing with the banking sector in Latvia and not to ignore the potential for criminals to utilize it for their own ends, but it is equally important to recognize the improvements that the sector has made. End Summary.

¶2. (C) In 2005, U.S. Patriot Act Section 311 actions against two Latvian banks cast a shadow of doubt and concern over the Latvian banking industry. (ref a) Since that time, government regulators and business associations have launched a major campaign to reestablish Latvia as a financial center and to attempt to shed their tarnished image. On May 7 post will host a digital video conference with Treasury Deputy Assistant Secretary Daniel Glaser. The purpose of the meeting, to include the FIU, FCMC, ALCB and bank compliance officers, is to discuss progress in Latvian banking compliance with AML laws since Treasury's banking conference in Vilnius last October. Although there is more work to be done, many of these changes are positive and encourage better-functioning compliance systems that leave Latvia's banking system less vulnerable to money laundering.

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AML and the Legislative System  
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¶3. (C) The new AML law, fully compliant with EU standards and known as the Law on Prevention of Money Laundering and Terrorist Financing, was passed in August 2008 with strong support from President Zatlers. (ref b) To ensure correct interpretation and implementation of the law's requirements, the FIU quickly trained the majority of banking compliance officers on its usage. According to the FIU and the FCMC, banks are now able to generate fewer, but more useful STRs based on real factors defined within the banks' internal systems. In response to the STRs, the law gives the FIU the power to freeze suspicious funds for a longer period of time, allowing for appropriate investigation of transactions.

¶4. (C) On the regulator side, the FCMC continues to strengthen its position. The July 2008 denial of the banking

license for the proposed new Ukrainian owners of 311 action VEF Banka (due to the bank's inability to identify the source of money to purchase the bank) (ref c) highlighted the FCMC's willingness and ability to persevere against strong pressure (largely from outside Latvia) to issue the license.

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Influence of the Economic Crisis on AML  
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15. (C) The economic downturn has been devastating for Latvia, but there has been a silver lining for compliance. First, since the end of 2008 there have been fewer nonresident deposits, reducing to some extent the potential risk commonly associated with these accounts. According to the FIU the most common STRs they have recently received from banks are for tax evasion in other countries (around 65% of reports). However, compared to last year, the number of these STRs has declined by about one-third, and transaction amounts involved are much lower. Second, the August 2008 timing of the AML Law and Enhanced Customer Due Diligence Measures were key. By the time the downturn hit, the FIU had trained most banks on the new law and they had started to implement changes in their systems. In most cases these compliance budgets and personnel are still in place and banks are reporting a smaller number but more useful STRs than in previous years. Third, in the midst of the downturn, the FIU managed to avoid budget cuts using the U.S. International Narcotics Control Strategy Report II, Money Laundering and Terrorism Finance section, as justification. The FIU is a small but important contributor to Latvian's AML structure and the dispensation

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from large cuts allowed them to retain staff and memberships to international cooperation organizations such as Egmont. To date, the FCMC has also avoided staffing cuts, in fact increasing their number of employees, and salaries have been reduced by a lower than average percentage.

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Parex Bank  
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16. (C) Parex Bank has historically been a money laundering concern. Although not included in the 311 measures, it was strongly considered for review. In November 2008 the Latvian Government took over the bank. (ref d) There was a fear that the former owners Valery Kargins and Viktor Krasovickis, who allegedly had ties to Russian organized crime, would be able to regain control easily. The government has since reversed its original decision to let Kargins and Krasovickis remain on the bank's board. With the new 25% ownership by EBRD, and the damning findings of a yet to be released Price-Waterhouse-Cooper government-mandated audit (which included an audit of AML compliance) it is highly unlikely that Kargins and Krasovickis will be able to buy back the bank and resume its former business model. Although the intense scrutiny Parex is experiencing now leaves little room for non-compliance with AML law, the FCMC remains vigilant in its dealings with the bank. The FCMC has forwarded a case for reprimand to the Prosecutor General, stating that, under previous management, some non-resident accounts were excluded from Parex's automatic compliance monitoring system.

17. (C) Comment: Latvia's geographic position, the technical ability of its population, and the public's complacency toward graft and corruption make it very attractive to money launderers and other criminals seeking to take advantage of the banking system. But it is impossible to ignore the attention that the Latvian government and the banking industry have paid to cleaning up the banks and strengthening oversight. Each major threat Latvia encounters forces them to build internal mechanisms and, step-by-step, makes them less open to criminal activity. As a result, it is improbable that

banks will return to the level of naivete and laissez faire that they allowed prior to 2005. It is important to recognize the progress that the banking industry has made since that time. We believe that Latvia will continue to improve oversight, if for no other reason than that Latvia's financial sector is one of its few competitive businesses.

End Comment

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